Uganda and Post-Conflict Recovery : 1992 (B)

Progress has been made, thought Francis Unyofu. Six years after Yoweri Museveni and his National Resistance Movement took power, Uganda has made remarkable strides in overcoming as grim a legacy as any African government has known. Improved security has been an important factor in allowing the country to rebuild. Economic policy has helped, too. The past six years has seen economic growth averaging over 5 percent per year, with idled land and vacant factories brought back into use. The economy has also achieved lower price inflation.

Now, in 1992, Uganda is at a crossroads. Economic growth is slowing, and inflation is beginning to rise. Uganda is highly indebted to foreign lenders. Further increases in capacity utilization will be a costly means to grow, and will not represent a strategy for sustained economic growth. Infrastructure remains inadequate in transport and communications. The preferred road is clear: public and private investments are needed to continue the reconstruction. Some of this can come from abroad, if Uganda's economic prospects appeal to international investors, although Uganda is currently seen as a high risk country. But what about the Ugandans, Francis thought?

It is June 1992 and Francis is a department head in the Finance Ministry -- now called the Ministry of Finance and Economic Planning (MFEP). The minister, his boss, is recently appointed -- Dr Kiyonga was replaced by Mr Joshua Mayanga-Nkangi, the former minister of planning and economic development. His department has been tasked to devise a strategy to increase productive investment over the next five years while maintaining fiscal and monetary discipline. The minister has asked Francis to direct this effort.

Overview of Policies and Aggregate Performance: FY 1987/88 - 1990/91

In May 1987 the Museveni government announced its first economic program. It had six basic components.

- A new Ugandan shilling went into circulation at a rate of 60 to the dollar. This represented a 77-percent reduction in value of the shilling. Old shillings could be converted to new shillings at the rate of 100 to 1, but such conversions were subject to a 30 percent tax.

This case is the second of a series of three created by Frank Warnock and Patrick Conway of the University of North Carolina at Chapel Hill on the subject of Ugandan economic growth. Thanks to Phillip English and Jorge Araujo for useful comments on its content.

- The four-year Rehabilitation and Development Plan (RDP) was inaugurated. This plan was a timetable for government expenditures designed to restore production capacity and rehabilitate economic and social infrastructure. The plan called for funding of US$1.3 billion over the four years, with transport to receive the major share (29 percent), followed by agriculture (24 percent), industry and tourism (21 percent), social infrastructure (17 percent) and mining and energy (7 percent).
- Prices paid to farmers were increased by up to 500 percent as an incentive to revive agricultural production.
- The price of petrol was increased by 50 percent, somewhat closer to its real market value, in an attempt to reduce smuggling and government outlays.
- The salaries of civil servants were doubled in an effort to restore some of their lost purchasing power.
- Under an IMF program, the government promised to tighten its budget and reduce inflation by restricting monetary expansion.

In the first year, insufficient tax revenues along with a falling international price of coffee led to a large budget deficit. The government turned to the Bank of Uganda to finance its deficit, thus continuing its inflationary policy of previous years. However, in July 1988 the government redoubled its efforts at macroeconomic stabilization. In his FY 1988/89 budget presentation, Finance Minister Crispus Kiyonga announced additional economic reforms:

- The shilling would be devalued by a further 60 percent to USh150 to the dollar;
- Further efforts would be made to reduce the budget deficit;
- Producer prices and public sector wages would be increased.

Still later, a policy of regular adjustments of the exchange rate to maintain a real effective depreciation was introduced.

In the period under consideration growth in real gross domestic product (GDP) exceeded 5 percent on average. In the prior fiscal year (FY 1986/87) real growth was 3.7 percent per annum; in the subsequent four fiscal years the annual growth rate averaged 6.2 percent. In FY 1991/92 the economic growth rate once again fell to under 4 percent per annum.[*]

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[*] Tables providing evidence corroborating the discussion in the text can be found in the appendix.

Both public and private investment increased during the period represented by FY 1986/87 to FY 1991/92. Private investment rose from 8 percent of GDP in FY 1985/86 to 10.6 percent on average for the period FY 1987/88 - 1990/91, but settled back to 9 percent of GDP in FY 1991/92. Public investment, by contrast, rose throughout the period from 3.5 percent of GDP in the prior fiscal year to 6.8 percent of GDP in the final year. The period 1980-1993 was characterized by a strong push in primary education, with tremendous increases in enrollment in that age cohort. Secondary education, however, remains below-average for low-income countries.

This investment was for the most part financed through foreign borrowing, as domestic saving (public and private) was negative on average for each period. The public fiscal deficit played a large part in this negative saving, with fiscal deficits rising from 4.2 percent of GDP in 1985/86 to 14.1 percent of GDP in 1991/92. In FY 1990/91 the annual inflation rate was down to 25 percent, representing a drastic improvement from the more than 200 percent inflation in 1986/87. However, as noted above, the inflation rate rose in FY 1991/92 to above 40 percent.

International Support for the Reform Program

The World Bank, IMF and other donors responded vigorously to Museveni's reform policies by pledging $310 million in aid in 1987/88. This was $50 million more than the government had sought, and was earmarked for purchase essentials – imports of raw materials, spare parts and capital goods needed to get production rolling again. All debt repayments Uganda was to make in the 1987/88 fiscal year also were rescheduled; this releasing the country from $66 million in international payments that year.

Government Budgetary Policy

The promise of fiscal deficit reduction did not materialize during the period FY 1986/87-1990/91. Government revenue remained quite low as international coffee prices plummeted, tax collection remained inadequate and the proposed sale of 22 parastatal enterprises did not develop as quickly as planned. With the government's commitment to public investment and the continuing petrol subsidy, reduction of the budget deficit became an impossible task. Fiscal deficits averaged nearly 7 percent of GDP in the late 1980s. Grants and foreign aid financed a portion of the deficits, but Uganda accumulated a substantial foreign debt as well. Uganda's debt service ratio (as a percent of exports) rose above 70 percent by 1991.

A number of government policies were aimed at reducing the adverse effects of these deficits.

- First, the government for the most part avoided borrowing from the Bank of Uganda in financing its fiscal deficits. It was increasingly able to turn to external

funding, both loans and grants, with the result that domestic borrowing averaged only 0.2% of GDP during these years.

- Second, the government lessened its reliance on revenues from coffee taxes and the Coffee Marketing Board (CMB). By FY 1990/91, coffee taxes and budgetary contributions of the CMB represented only 10 percent of government revenue, down from 35 percent in FY 1986/87. This was accomplished by a reduction in the coffee export tax rate and increased collection of customs duties and sales taxes, which became the principal sources of recurrent revenue by 1990/91.

The Museveni government also became more successful in income tax collection through increased delegation of responsibility for collection on local governments. Nevertheless, the restructuring of revenue collection was hampered by the sheer size of the non-monetary sector. Although its importance declined during this period, at the end of the period it reportedly still represented 32 percent of total economic activity.

The government realizes that social and infrastructural spending has been inadequate as central government spending has, in the past, been dominated by defense. Official numbers indicate that defense swallowed 22 percent of government spending in 1990/91, although unofficial estimates are closer to 50 percent. At the same time, education received only 14 percent of recurrent spending, and health a meager 5 percent.

To be sure, the government has tightened its belt in some areas. For example, the civil service has undergone a restructuring as almost one-half of the 225,000 civil service positions have been eliminated in the 1990/91. Unfortunately, this has done little for the image of the government as many lower-level workers were released while the extravagance of higher-level officials is chronicled daily in the press. Moreover, those still at work earn a less-than-subsistence salary. At the bottom end of the ladder civil servants earn only 1000 shillings per month, or the price of a bunch of bananas. Permanent secretaries earn 6000 shillings monthly. Most bureaucrats spend much of their time working on outside income-earning activities.

Financial Sector Development

Most private citizens had access to commercial banks or other saving institutions, but they remained uninterested in depositing their earnings with those institutions. In 1970, banks held time deposits valued at 5.9 percent of GDP, but by 1989 the same ratio had fallen to 0.7 percent. (By contrast, in 1991 in neighboring Kenya time deposits represented 17 percent of GDP of that country.)

Two reasons appeared paramount in the private choice not to save through the banking system:

- Nominal interest rates were set by the Bank of Uganda, but these rates were in annual terms lower than the inflation rate. Putting money in the bank was thus a

losing proposition for Ugandans, as the purchasing power of the funds withdrawn from the bank, even after interest was earned, was less than its original value.

- Corruption scandals have lowered confidence in banking institutions. In 1989, the state-owned Uganda Commercial Bank (UCB) was charged with defrauding depositors. In 1991 the UCB was again linked to a conspiracy to defraud the government. (A Danish aid worker discovered the conspiracy, and was subsequently shot in broad daylight in Kampala.) These frauds were associated with documented mismanagement at UCB; they were made worse in the public eye by the extravagant lifestyle of UCB's managing director. High-ranking officials in other banks were also charged with fraud. Also in 1991 the manager of the Orient Forex Bureau was arrested at Entebbe airport while smuggling out US$1 million in cash, traveler's cheques and bank drafts.

There was apparently inadequate supervision of the banking system provided by the Bank of Uganda: indeed, reserves against deposits were discovered in the banks investigated to be woefully below the required 10 percent. There is also evidence of insolvency on the part of the larger commercial banks, including the state-owned UCB. These banks have substantial accumulated losses, a high proportion of nonrecoverable loans and a weak cash flow.

Foreign Exchange Availability

Foreign exchange remained the single biggest constraint for businesses. Hard currency continued to be available only erratically and without advanced notice, making planning impossible. According to one report, even some parastatals (government-controlled enterprises, many of which were confiscated or taken over when abandoned by Asians expelled in 1971) were driven to buy dollars on the *kibanda* (informal -- and illegal) market to pay for essential imports. Moreover, the Bank of Uganda was under attack for widespread mismanagement and corruption in the area of foreign exchange and import licenses. In an attempt to gain some control of the illegal market in hard currencies, in 1990 the government legalized the *kibanda* by introducing a system of authorized foreign exchange (forex) bureaus.

The continued overvaluation of the shilling on the official foreign exchange market made life difficult for Ugandan exporters. Even with periodic devaluations, the shilling was vastly overvalued: the *kibanda* rate was typically two or three times higher than the official rate. Even the later policy of real effective depreciation was only partially successful. This helped to close the gap between the official and *kibanda* rates, but even by 1991 the official rate was up to 558, compared to 780 in the forex bureaus, for a premium remaining of 40 percent. Not surprisingly, Uganda's annual trade deficit averaged over US$400 million.

Agricultural Sector Performance

Much of Uganda's economic growth during this period is attributable to the agricultural sector. The US$400 million in funding from the RDP helped, as did improvements in infrastructure. Efforts were made both to increase production of traditional cash crops (coffee, cotton, tea and tobacco) and to promote the cultivation of nontraditional agricultural crops (NTA) such as maize, beans, peanuts, soybeans, sesame seeds, and a variety of fruits. Traditional cash crops on average contributed little during this period to real GDP growth, but the NTA crops contributed just under 30 percent of observed real growth.

There was a resurgence of some of the traditional cash crops. Recognizing the linkages cotton has with other industries such as local textile mills, soap factories and animal feed, the government initiated an emergency cotton production program in 1989 that provided extension services, tractors and other inputs for cotton farmers. Although cotton suffered from rural insecurity and labor shortages in the central and southeastern regions of the country, exports increased from about 3,000 tons per year in the late 1980s to nearly 8,000 tons in 1991.

The return of Asians expelled in the early 1970s revitalized the tea and sugar sectors. Tea exports rebounded dramatically, rising from 2,000 to 3,000 tons in the late 1980s to 7,000 tons in 1991. Sugar production also increased substantially -- from nil in 1987 to over 40,000 tons in 1991 -- as old estates were rehabilitated in joint government ventures with the original owners.

This period was unfortunately a difficult time for Ugandan coffee growers, and this pulled down the average contribution of cash crops to GDP growth. Even in good times the price the Coffee Marketing Board (CMB) paid to growers never amounted to much more than one-tenth of the world price. In December 1988, the situation got worse: due to its own budgetary shortfalls the CMB was unable to pay farmers for new deliveries. Although the government agreed to provide funds for these obligations, some farmers were unpaid for another year. There was a further deterioration in July 1989 when the International Coffee Organization -- a consortium of coffee-producing nations that set international production quotas and prices -- collapsed and coffee prices plummeted. Furthermore, the government continued to apply the official exchange rate to coffee exports (but not to other exports), denying the industry the benefits of the more advantageous rates of the new forex bureaus.

Coincident with the collapse in world coffee prices the government took the first step in liberalizing the Ugandan coffee market. In 1990 the CMB's monopoly in the export of coffee was broken as four private cooperatives were licensed to export directly. However, low production and farm level productivity – many of the coffee trees were over 40-50 years old and had reached the end of their economic life -- continued to plague the coffee sector.

As the domestic market is small, agricultural exports are the key for growth. Several government programs were aimed at expanding NTA exports. In late 1988 the government made it easier for private companies to retain foreign exchange earned for NTA exports, and to use it to purchase imports. The general patterns of NTA exports have been quite erratic, however, and have been importantly influenced by exogenous factors such as the 1990-91 drought in Sudan.

Manufacturing and Service Sector Performance

The industrial sector grew strongly in the late 1980s. It began (and remained) a small percentage of total GDP, but it represented between 20 and 40 percent of the annual contributions to aggregate growth observed in the period 1986 to1992. Construction was the most buoyant part of the industrial sector, but manufacturing grew strongly during this period as well. The services sector represented about one-third of GDP throughout this period, and grew at roughly the growth rate of GDP..

A main goal of the government in the late 1980s was to decrease Uganda's dependence on imported manufactured goods by rehabilitating existing enterprises. However, run-down plant and equipment, and shortages of spares and foreign exchange, continued to hamper the manufacturing sector's recovery. Growth in construction was strong but held back by a shortage of inputs such as cement, even though the requirements for basic construction are all produced locally.

The Current Situation: June 1992

The fiscal year 1991/92 has been a difficult one in Uganda. Real GDP growth, which averaged over 5 percent per year in the first five years of Museveni's regime, slowed to 3.6 percent as a drought reduced crop production. Coffee prices did not recover, and coffee export receipts fell to US$117 million, one-third of the FY 1986/87 level. Imports fell to levels not seen since 1986. Donor countries slowed aid disbursements, thus necessitating government borrowing from the Bank of Uganda to finance a large fiscal deficit. The drought put upward pressure on food prices, and this, coupled with the increased government borrowing, resulted in a setback on the inflation front as inflation increased to 42 percent. The shilling continued its depreciation on the *kibanda* market to 1000 per US dollar, a 76 percent fall in value from the previous year.

The new four-year Rehabilitation and Development Plan continues the government's aggressive public expenditure policy, but emphasizes changes in the government's spending priorities. Resources are being switched out of the productive sectors into social infrastructure, primarily as a result of the government's determination to fight the AIDS epidemic. Water projects are also receiving a greater share compared to the previous RDP; less funds are available for manufacturing and agriculture.

The public is growing increasingly disillusioned with high-level corruption. The ministries of agriculture, commerce and energy have figured prominently in continuing revelations of corruption and malpractice. Corruption is also reportedly hampering the sales of parastatals, as there is talk of delays designed to favor candidates with government links. Problems with corruption persist throughout the civil service, where salaries are still too low.

On 28 March 1992 Crispus Kiyonga, the finance minister since November 1986, was sacked. A new joint ministry of finance and economic planning was formed. His replacement was Joshua Mayanga-Nkangi, formerly minister of planning and economic development. Nkangi pledged to get back on the path of fiscal and monetary discipline that Kiyonga had initially chosen.

Policy Dilemma

Economic growth during the first six years of the Museveni government was strong, especially when compared to the previous economic results of Uganda. Now, in mid-1992, there is evidence that the engine of growth for that period has run out of steam. A trickle of foreign investment has come into Uganda, especially as expropriated properties are returned to the owners, but investor confidence remains low. Finance Minister Nkangi is committed to maintaining tight fiscal control in a period of lagging fiscal revenues. The scope for expansion without active private participation in productive investment is thus likely to be limited.

Francis Unyofu's department must devise an economic strategy to increase productive investment while maintaining fiscal and monetary discipline. The minister recognizes that this might require a reallocation of existing public investment funds, and seeks recommendations of such reallocations if necessary.

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Sources

Francis Unyofu is a creation of the authors, but the other details of the Ugandan history are factual. Rather than interrupt the narrative throughout we credit in this section those sources from whom substantial information has been drawn. More detailed citations are available, when needed, from the authors.

Overview of 1987 Policies and Outcomes - drawn from Library of Congress (1992) and EIU Country Profile (1988).
A Measure of Success - drawn from EIU Country Profile (1991), Library of Congress (1992) and various articles that appeared in the New York Times, the Economist and the Financial Times, with precise citations available from the author.
The current political situation: June 1992 - drawn mainly from EIU Country Report (1992).

Appendix B.

Table B1. GDP by Sector at Constant 1991 Prices, percent of GDP, FY 1985/86 - 1991/92.
Table B2. GDP by Sector at Constant 1991 Prices, growth rates, FY 1985/86 - 1991/92.
Table B3. Sectoral Contributions to Real GDP Growth, FY 1985/86 - 1991/92.
Table B4. GDP by Expenditure at Constant 1991 Prices, percent of GDP, FY 1985/86 - 1991/92.
Table B5. GDP by Expenditure at Constant 1991 Prices, growth rates, FY 1985/86 - 1991/92.
Table B6. Production of Principal Commodities, 1986 - 1992.
Table B7. Exports of Cash Crops, 1986 - 1992.
Table B8. Balance of Payments, FY 1985/86 - 1991/92.
Table B9. Exchange Rates, FY 1985/86 - 1991/92.
Table B10. Financial Indicators, FY 1986/87 - 1991/92.
Table B11. Central Government Operations, FY 1985/86 - 1991/92.
Table B12. Destination of Central Government Operations, FY 1985/86 - 1991/92.

Chart: Price of Ugandan coffee, USD/lb., 1965 - 1992.